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EXPIRING CIGARETTE EXCISE TAX PROVISIONS—II

HEARING

BEFORE THE

SUBCOMMITTEE ON
TAXATION AND DEBT MANAGEMENT

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

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EXPIRING CIGARETTE EXCISE TAX—II

MONDAY, SEPTEMBER 16, 1985

U.S. SENATE,
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT,
COMMITTEE ON FINANCE,
Washington, DC.

The committee met at 11:08 a.m., in room SD-215, Dirksen Senate Office Building, the Honorable John H. Chafee (chairman) presiding.

Present: Senator Chafee.

Senator CHAFEE. We have a continuation of the hearing we had the other day on legislation dealing with taxation of cigarettes.

Mr. Kerrigan of the Smokeless Tobacco Institute was unable to testify Monday, and so we've arranged for him to testify today.

We welcome you, Mr. Kerrigan, and if you want to proceed. We have got your statement, and you can proceed for 5 minutes in your presentation. There will probably be some questions.

Mr. KERRIGAN. Mr. Chairman, before I begin my remarks, I'd like to personally thank you for permitting me to testify a week late when I could have testified. I appreciate that.

Senator CHAFEE. Well, you had a powerful advocate. When you have President Carter call for you, it's pretty hard to turn down a former President of the United States. I hope your conference went well down there.

Mr. KERRIGAN. Well, it was an interesting conference. And I chatted with Christine about it. The fact that he was a former submariner, I thought, was probably more important than he was a former President of a different party.

STATEMENT OF MICHAEL J. KERRIGAN, PRESIDENT, SMOKELESS TOBACCO COUNCIL, INC.

Mr. KERRIGAN. Mr. Chairman, I am Michael J. Kerrigan, president of the Smokeless Tobacco Council and Association of Smokeless Tobacco Manufacturers. I'm here today to express our strong opposition to an excise tax on smokeless tobacco because we believe such a tax would be confiscatory, punitive, regressive, and inconsistent with the goals of tax reform.

The smokeless tobacco industry is opposed to a destructive plan to tax its products. The estimated revenue from the highest proposed tax is $700 million, which would equal the total industry sales in 1984. The proposed taxes are so large that they would easily and quickly destroy a $700 million industry.

Now there is a significant and illogical discrepancy between the size of the proposed excise taxes on smokeless tobacco and every other current excise tax on consumer products.

This chart—there is the product—but the next chart, Hartman, would show——

Senator CHAFEE. Why don't you put up the product?

Mr. KERRIGAN. OK. Could you put up the product for the chairman?

Senator CHAFEE. I'm most familiar with seeing this advertised on the sides of barns.

Mr. KERRIGAN. Yes, sir.

Senator CHAFEE. What are some of the famous names?

Mr. KERRIGAN. Mail Pouch.

Senator CHAFEE. Mail Pouch, right.

Mr. KERRIGAN. Redman, Chattanooga Chew, Levi Garret.

Senator CHAFEE. Do you still paint on the sides of barns?

Mr. KERRIGAN. Well, I don't do the painting, Mr. Chairman.

Senator CHAFEE. I know you don't, but I mean your companies. Redman, Mail Pouch?

Mr. KERRIGAN. Yes, sir. That's a form of advertising.

Some of these products go back to before Rhode Island was 1 of our first 13 States. They go back to colonial times.

Senator CHAFEE. Is that right?

Mr. KERRIGAN. Yes, sir. Particularly, some of the more obscure twists and plugs.

Senator CHAFEE. Why don't you point out some. I can't see them all.

Mr. KERRIGAN. Yes, sir.

Senator CHAFEE. What are they?

Mr. KERRIGAN. Twist is almost pure, right off the plant—it's called "twist tobacco."

Senator CHAFEE. Right.

Mr. KERRIGAN. The cigar-looking type of tobacco is actually chewed. It's also a form of chewing tobacco. Moist plug in the upper right hand corner, during the War Between the States, or, if you prefer, the Civil War, they took their knife—every soldier on both sides was issued plug tobacco. And they took their knife and just cut it off and chewed it. And that's primarily from the chewing tobacco side of the industry, sir.

The buttercup dental scotch, that's called dry snuff. We have 185 different sizes and shapes of products in our industry. The dry snuff is primarily a female-oriented product, sir. And the moist snuff, the Copenhagen and Skol cans, which are probably more prevalent today——

Senator CHAFEE. You inhale those, don't you?

Mr. KERRIGAN. No, sir. No American—not since colonial; not since the Tories went up to Canada do we use snuff nasally. In America, it's all used orally.

Senator CHAFEE. Copenhagen, snuff said. Is that right? What did Nelly Fox use?

Mr. KERRIGAN. Nelly Fox, the 1959 White Sox World Series, baseball player used plug and chewing tobacco. A big plug sticking out of his mouth, if you recall. I wish today's ballplayers would be

using more chewing tobacco and snuff than the illegal stuff some are currently using.

Senator CHAFEE. All right. Now you have got another chart.

Mr. KERRIGAN. Yes, sir.

This chart shows the sizable difference between the tax rates on, say, at $0.32 an ounce, 046.2 percent of our product cost, of the selling price rather, all the way to cigarettes. If cigarettes were selling at a dollar and you had a $0.16 tax on them today. If you compare some of the tax rates that are being discussed today, sir, even on alcohol, there are just huge discrepancies to our products.

Senator CHAFEE. Explain this chart a little more. What are you doing? You are taking the percentage of the tax vis-a-vis the normal cost of the product without tax? Is that what you are doing?

Mr. KERRIGAN. Well, for simplistic terms, Mr. Chairman, if you look at cigarettes, if they sold for about a dollar.

Senator CHAFEE. I can't see that chart. Why don't you bring it up front?

Mr. KERRIGAN. Sure.

If cigarettes were to sell for about a dollar and you had a Federal tax, and I know some others would prefer a different Federal tax, but if you had a $0.16 tax——

Senator CHAFEE. Which is the existing Federal tax.

Mr. KERRIGAN. Yes, sir.

Senator CHAFEE. Now you are saying that that——

Mr. KERRIGAN. Would be 16 percent of its selling price, as an example.

Senator CHAFEE. I see.

Mr. KERRIGAN. And some of the other rates that have been discussed in the other Chamber in terms of taxes per ounce would show you how incredibly different the tax rates would be on smokeless. Far higher than any consumer product. That's just used to exemplify the differences.

Senator CHAFEE. Well, when you say the pack of cigarettes sells for a dollar, that is, with the tax——

Mr. KERRIGAN. Yes, sir.

Senator CHAFEE. The tax at $0.16 Federal is 16 percent.

Mr. KERRIGAN. Yes, sir.

Senator CHAFEE. Now your product would sell at $1.30 or whatever it is?

Mr. KERRIGAN. Well, let's take that Mail Pouch on the barn. Three ounces of that—it's about 3 ounces in a pouch of Mail Pouch. If you tax it at $0.32 an ounce, that would be $0.96. And it sells for, I believe, around $0.90 to $1.

Senator CHAFEE. It does now?

Mr. KERRIGAN. Yes, sir. That's right.

Senator CHAFEE. Let's go slow. What's the tax currently?

Mr. KERRIGAN. There is no Federal tax on smokeless tobacco, sir.

Senator CHAFEE. So smokeless tobacco, let's take the Mail Pouch. Three ounces, you say, is traditionally the pack.

Mr. KERRIGAN. The traditional pack, yes.

Senator CHAFEE. Now that sells for how much now?

Mr. KERRIGAN. Ninety cents to a dollar, depending on the part of the country.

Senator CHAFEE. Well, let's call it $0.90. So it would sell with the $0.16, add the $0.16, and sell for $1.06. And so the $0.16 would be less than 16 percent.

Mr. KERRIGAN. The $0.16 cents—Hartman, do you want to help on this?

Mr. ROEMER. Hypothetically——

Mr. KERRIGAN. He said just hypothetically if they were. No, no, per ounce.

Senator CHAFEE. Oh, it would be $0.16 an ounce?

Mr. KERRIGAN. Yes, sir.

Senator CHAFEE. That is what is proposed.

Mr. KERRIGAN. That is a proposal that's out.

Senator CHAFEE. You start with 90——

Mr. KERRIGAN. Three ounces is $0.48.

Senator CHAFEE. Forty-eight, fifty percent of a dollar.

Mr. KERRIGAN. Fifty percent of a dollar.

Senator CHAFEE. And so you go to $1.38.

Mr. KERRIGAN. That's if they pass the tax solely through——

Senator CHAFEE. So that would put it up to $1.86.

Mr. KERRIGAN. That could be a hypothetical. The point is that it is so far out as you compare it to other products.

Senator CHAFEE. All right.

Mr. KERRIGAN. It also should be rejected because you were sensitive to the poor earlier. Excise taxes are taxes on consumptions. And the poor spend a great deal of their income on consumption. An excise tax on somkeless tobacco is particularly regressive because our consumers are poorer than the average consumer.

Hartman, if you would pull the next chart.

Twenty-five percent of smokeless tobacco users have an annual household income of less than $15,000. One-half of all smokeless tobacco users' household income in 1984 was $25,000. So it's clear that a proposed excise tax is contrary to the most basic principle of our Tax Code. That the poor should not bear a greater tax burden than the rich.

I think it's also inconsistent, Mr. Chairman, with the goals of tax reform and simplification. The primary thrust of our Tax Code is to make more fairer by eliminating special interest preference and broadening the tax base.

The excise tax, however, would single out one group consisting primarily of blue-collar workers with very low household incomes for unusual punitive treatment. So broadening the tax base, this excise tax would discriminate against those least able to pay.

The excise tax cannot be justified on the basis that we are not paying enough taxes. Mr. Chairman, the average tax rate for the smokeless tobacco industry is 40 percent. And considering how many other corporations pay very little, 40 percent is certainly more than our fair share of Federal corporate taxes.

And, significantly, a Federal tax would be an encroachment on the tax bases which currently provide an important source of State revenue. It's taking place at a time when the Federal Government is reducing its aid to the States.

Senator CHAFEE. Well, do many States tax smokeless tobacco?

Mr. KERRIGAN. About half of them, sir. Twenty-three, to be exact, do tax smokeless tobacco.

Senator CHAFEE. Do you have a list of what those taxes are?

Mr. KERRIGAN. Yes, sir. I had it in the Tollison paper. Alabama, I think is an instructive one. I forget what page it is on.

But the National Governors and the National State Legislators have gone on record saying that excise taxes should be reserved as a source of revenue for the States.

In summary, Mr. Chairman, excise taxes on smokeless tobacco are, indeed, confiscatory; they are punitive, regressive and inconsistent with the Tax Code.

In addition, a Federal excise tax on smokeless tobacco would erode the ability of individual States to generate essential revenue and would destroy an industry that provides thousands of jobs in several States.

We would respectfully request any excise tax on smokeless tobacco to be rejected.

Thank you, Mr. Chairman.

[The prepared written statement of Mr. Kerrigan, and the Tollison study follow:]

Smokeless
Tobacco
Council, Inc.

STATEMENT OF MICHAEL J. KERRIGAN

REGARDING PROPOSED FEDERAL LEGISLATION
IMPOSING AN EXCISE TAX ON SMOKELESS TOBACCO

I am Michael J. Kerrigan, president of the Smokeless Tobacco Council, Inc., an association of smokeless tobacco manufacturers. We are here today to express our strong opposition to an excise tax on smokeless tobacco because such a tax would be confiscatory, punitive, regressive and inconsistent with the goals of tax reform.

The smokeless tobacco industry is diametrically opposed to this destructive plan to tax its products. The estimated revenue from the highest proposed tax is $700 million. This equals almost the total industry sales. The proposed taxes are so large, they would easily and quickly destroy our small $700 million industry. And when our industry is destroyed, so are jobs and individual lives. It will only contribute to the dramatic and daily loss of manufacturing jobs from which this country already suffers.

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There is a significant and illogical discrepancy between the size of the proposed excise taxes on smokeless tobacco and every other current excise tax on consumer products. This chart shows the sizeable differences between tax rates.

Ironically, excise tax proposals on smokeless tobacco have surfaced within weeks of the 20th anniversary of the Excise Tax Reduction Act of 1965, which among its other provisions abolished the then 10 cents per pound tax on manufactured tobacco on the basis that such a tax was the most regressive of all excise taxes. What differentiates the current excise tax proposals from their predecessor is the incredible size of the tax rate that would be imposed. For example, if the 1965 excise tax was simply reintroduced in terms of current dollars, the rate would be set at 24 cents per pound, or 1.5 cents per ounce. This is a far cry from the proposed excise tax of 16 or 32 cents per ounce or fraction thereof. [Indeed, a tax per ounce or fraction of an ounce is truly ruinous.]

Congress must recognize that tax revenues will not increase by taxing the smokeless tobacco industry out of business. In fact, the destruction of this industry would result in a decrease in federal tax revenues due to the loss of jobs and relative federal income taxes now paid.

The proposed excise tax on smokeless tobacco should also be rejected because it is essentially a tax on the poor--as are all excise taxes. Because excise taxes

are taxes on consumption, and the poor spend a great deal of their earnings on consumption, the poor are the hardest hit by an excise tax. An excise tax on smokeless tobacco is particularly regressive because smokeless tobacco users are generally poorer than the average consumer.

[SHOW CHART]

As this chart shows, 25 percent of smokeless tobacco users have an annual household income of less that $15,000. Only 18 percent of all men nationally have household incomes of less than $15,000. More significantly, fully one-half of all smokeless tobacco users had household incomes of less than $25,000 in 1984. It is clear that this proposed excise tax is contrary to the most basic principle in our tax code--that the poor should not bear a greater tax burden than the rich.

It is also inconsistent with the overall goals of tax reform and simplification. The primary thrust of tax reform is to make the tax code more fair by eliminating special interest preferences and by broadening the tax base. This excise tax, however, would single out one group--consisting primarily of blue collar workers with very low household incomes--for unusually punitive tax treatment. So, rather than broadening the tax base, this excise tax would selectively discriminate against a group which includes those least able to pay.

Certainly, the proposed excise tax cannot be justified on the basis that the smokeless tobacco industry is not paying enough in taxes. The industry already pays

significantly more in federal income taxes than the overall corporate average. In fact, the smokeless tobacco companies pay an average of 40 percent of their income in federal taxes. Considering how many corporations pay very little or no income taxes whatsoever, 40 percent is certainly more than a fair share.

By imposing such a huge federal excise tax, the ability of the individual states to generate revenues from their excise tax is severely limited. Significantly, this encroachment on the tax bases which currently provide an important source of state revenue is taking place at a time when the federal government is reducing its aid to states. Because of the states' substantial reliance on excise tax revenues, the National Governor's Association and the National Conference of State Legislatures have gone on record in saying that excise taxes should be reserved as a source of revenue at the state level. [This is a view that the White House appropriately supports.]

In short, these excise tax bills would impose a tax which is confiscatory, punitive, regressive and inconsistent. In addition, a federal excise tax on smokeless tobacco would further erode the ability of the individual states to generate essential revenue and would destroy an industry that provides thousands of jobs in several states.

Any excise tax on smokeless tobacco should be soundly rejected.

ECONOMIC ANALYSIS OF PROPOSALS TO IMPOSE A FEDERAL EXCISE TAX ON SMOKELESS TOBACCO PRODUCTS

Prepared by

Dr. Robert D. Tollison
Center for Study of Public Choice
George Mason University

August 1985

I. INTRODUCTION

At least three legislative proposals which would impose federal excise taxes on chewing tobacco and snuff are currently being considered by Congress. One bill, H.R. 3064 introduced by Representative Tauke, calls for an excise tax in the amount of 16 cents per ounce; another, H.R. 3078 by Representative Collins, would levy an excise of 32 cents per ounce. In addition, the Collins bill seeks to restrict the advertising of smokeless tobacco products by denying any income tax deduction to producers for expenditures made for such purposes. Senator Chaffee may also be planning to introduce smokeless tobacco legislation.

Ironically, these legislative proposals have surfaced within weeks of the twentieth anniversary of the Excise Tax Reduction Act of 1965 (P.L. 89-44), which among its other provisions, abolished the then 10 cents per pound tax on manufactured tobacco. The principle reason for abolishing the manufactured tobacco tax was a recognition by Congress of its extreme regressivity. Evidence presented at the various hearings on P.L. 89-44 suggested that the levy on manufactured tobacco was the most regressive of the federal excise taxes then in effect.

What differentiates the current excise tax proposals from their predecessor are the magnitudes of the tax rate that would be imposed if any of the bills were enacted. For example, if the 1965 excise on smokeless tobacco was simply reintroduced in terms of current dollars, the tax rate would be set at 24 cents per pound, or 1.5 cents per ounce, not in the range of 16 to 32 cents per ounce. The tax rates now under discussion are ten to twenty

times the 1965 level, suggesting that the bills are not designed to raise revenue, but rather to punish the smokeless tobacco industry. When compared with the old federal excise tax on manufactured tobacco, with the rates levied by the states which tax these products, or with the prevailing federal excises on other goods such as beer, wine, gasoline, and cigarettes, the proposed federal excise on smokeless tobacco can only be described as a bankruptcy tax.

The confiscatory nature of the proposed tax becomes even more apparent when measured against the sales revenue currently generated by the smokeless tobacco industry. The $350 million in tax receipts which some have argued would be raised by the levy represents half of annual industry sales. It is inconceivable that the industry could survive such a burden, expecially in view of the fact that the companies which manufacture smokeless tobacco products are already good taxpayers. In contrast to many other business firms, the smokeless tobacco industry faces a tax rate on corporate income of about 40 percent.

The Congress must consider the economic and social implications of these new excise tax proposals, the costs and benefits expected to accrue to all affected parties, and the broad questions concerning the proper role of government and government regulation of individual behavior before reaching a final decision.

This study will review these major issues. Specifically, the following report considers the incidence of the proposed smokeless tobacco tax against the widely-accepted standards of horizontal and vertical equity in taxation and finds that the

burden of an excise tax on chewing tobacco and snuff would fall most heavily on those individuals at the lower end of the income distribution, meaning that the proposed tax is regressive and violates the principle that taxes should be levied on the basis of ability to pay. In addition, excise taxes always distort economic efficiency -- they cost jobs in the economy.

Next, this report reviews the various proposals to earmark some or all of the revenues generated by the proposed tax for specific programs such as Medicare and Medicaid, or for publicity campaigns on the alleged health consequences associated with the use of smokeless tobacco products. It is shown that the main premise of such earmarking proposals is faulty, and results from a confusion between private costs and social costs.

This study also offers comments on the issue of federalism -- whether or not it is appropriate for the federal government to encroach on a tax revenue source already tapped at the state level -- and argues that if despite the lack of justification a tax on smokeless tobacco is enacted, it should take account of the fact that chewing tobacco and snuff are normally purchased in packages of different net weight. Congress should apply different tax rates to the two tobacco products.

In sum, this report concludes that the proposals for levying a tax on smokeless tobacco should be opposed for reasons which come under the general heading of fairness and economic efficiency. It is the purpose of this report to lay out a comprehensive set of arguments concerning why there is no reasonable basis for placing a federal excise tax on chewing tobacco and snuff.

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II. EQUITY AND EFFICIENCY OF TAXES ON SMOKELESS TOBACCO

Federal excise taxes on smokeless tobacco products would push our tax structure further in the direction of inequities and inefficiencies of the type which are increasingly being recognized as unacceptable. Our existing tax system imposes burdens which have nothing to do with the benefits received for government services or with the ability to pay. Tax policy increasingly discriminates against particular income classes and groups for no other reason than that they have neither the financial resources nor the political influence to avoid them. By disproportionately burdening some activities while exempting others, our tax system is distorting economic decisions at all levels and reducing the ability of our economy to satisfy the demands of consumers efficiently.

It is these inequities and inefficiencies generated by our federal tax system which explains the interest currently being expressed in Congress over tax reform. The goal of tax reform is to increase the efficiency and fairness of the tax code, and the modified flat rate proposals currently being considered by Congress would go a long way toward realizing this goal. By broadening the tax base and lowering tax rates, efficiency is served by reducing both the incentive and opportunity to make economic decisions which are profitable at the private level but wasteful at the social level. Basic fairness would be served by a modified flat rate tax since the removal of tax loopholes would make it less likely that some will bear heavier tax burdens than others who are similarly situated.

It is difficult to understand how Congress, which is considering tax reform seriously, can at the same time take seriously proposals to reimpose an excise tax on snuff and chewing tobacco. Such a tax would exacerbate exactly the type of economic perversities which those behind the tax reform movement are hoping to reduce. Rather than closing off special-interest tax preferences and thereby allowing the tax burden to be spread more lightly over all economic activities, an excise tax on smokeless products would single out a narrow category of products and impose a discriminatory tax burden on them. Tax reform is aimed at allievating the tax burden precisely on the type of citizen represented by the average consumer of smokeless tobacco.

Excise Taxes and Economic Efficiency

In addition to the blatant unfairness of such a tax, it also inserts a "wedge" between the price paid by those who wish to consume smokeless tobacco products and the price received by producers. Faced with the resultant higher prices, consumers will cut back on their use of smokeless tobacco. Faced with a decline in sales, suppliers will layoff workers and spend less on other inputs as they reduce production. This requires that the discharged productive resources seek employment elsewhere in the economy where, even when successfully re-employed, they will end up producing products which consumers value less than the goods they would have purchased in the absence of the discriminatory excise tax. The result is a misallocation of productive resources in the economy, which means a reduction in our economic productivity and a deadweight loss to society. And unlike the revenues

raised by the tax, this deadweight loss is not simply a transfer of wealth from one group in the society to another by way of the government. Instead, it represents a real loss of wealth, that is, the productive capacity of the economy is permanently lower than it would otherwise have been.

The general argument here is not specific to an excise tax on smokeless tobacco products; it is just as valid with regard to excise taxes on a wide range of products. The initial justification for excise taxation was that it provided a way to tax luxury goods, presumably being consumed by the wealthy. There may have been a period in our history when such a justification had some basis in fact and the economic inefficiencies generated by excise taxes were compensated for by equity considerations. Today, however, it is hard to make the case that federal excise taxes on beer, wine, cigars, cigarettes, and tires are luxury taxes. The low-income worker who enjoys some smokeless tobacco on the job, and has a beer when he gets home in the evening, is almost surely not a rich, luxury-consuming individual who deserves to be singled out by tax system and punished for his consumption choices. Interestingly, the federal excise taxes on furs and jewelry, goods which could still qualify legitimately as luxury goods, were repealed in 1965.

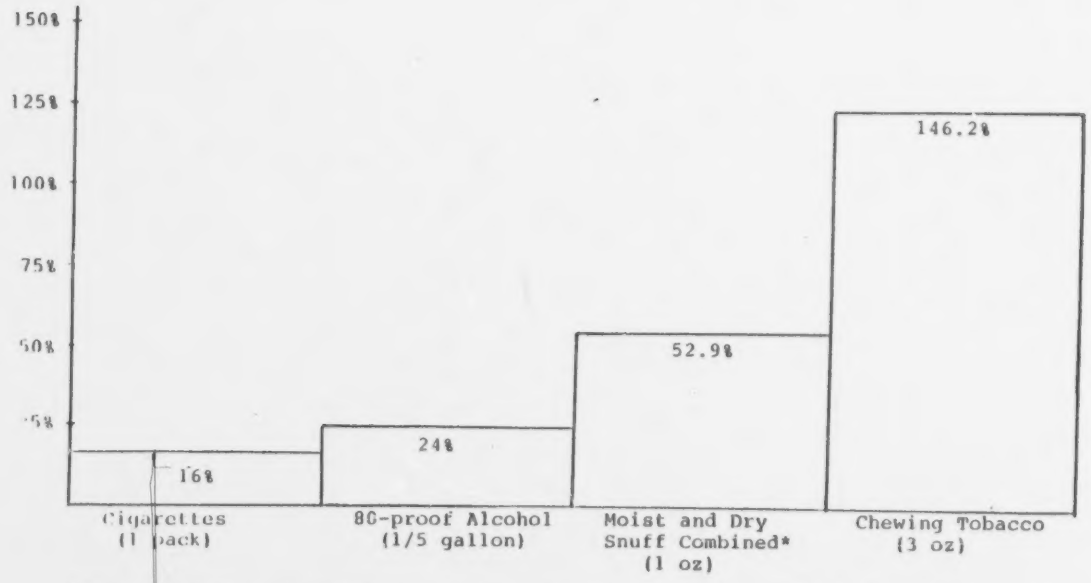
Although the excise taxation of many products violates the norms of efficiency and equity, the proposed excise taxation of snuff and chewing tobacco is particularly offensive in this regard. For example, if House Resolution 3078, which had been introduced by Congresswoman Collins, is enacted, then the federal tax on smokeless tobacco, as a <u>percentage of the pre-tax value of</u>

the product, will be substantially higher than the federal excise tax on any other good. Even if the less pernicious House Resolution 3064, introduced by Congressman Tauke, is enacted, the distorting effect with respect to smokeless tobacco production and consumption decisions would still be large relative to the distorting effect of excise taxation on other targeted goods. Comparisons among different products of this economically relevant measure of the distorting impact of excise taxes are presented in Figure 1. In both cases the wedge which would be inserted between the price consumers pay and the price suppliers receive would motivate a significant diversion of resources out of more valued and into less valued productive activities. The excise tax on alcoholic beverages, for instance, is levied at the rate of $10.50 per proof gallon. This translates into a tax of $1.68 for 80-proof liquor in a one-fifth gallon bottle. Similarly, the federal excise tax on cigarettes represents 16 cents of the current retail price of roughly $1.00 per pack. Both of these figures pale in comparison with the excise tax rates currently being considered for chewing tobacco and snuff. As a percentage of pre-tax price, the proposed federal levies on smokeless tobacco can only be described as punitive: they are at such a high level that their purpose cannot be to raise tax revenue, but rather to prevent individuals from purchasing products they would otherwise freely choose to consume.

There is another distortion that would result if any of the smokeless tobacco taxes were adopted. All of the proposals fail to recognize that an ounce of chewing tobacco is not equivalent to an ounce of snuff. As a rough rule of thumb, a 1.2-ounce tin

FIGURE 1. EXCISE TAX: PERCENTAGE CHANGE OVER RETAIL PRICE

(32¢ per ounce tax on smokeless tobacco)



*Because of the many different sizes of snuff, 1 oz is used here for illustrative purposes as a standard size.

of snuff is equivalent to a 3-ounce pouch of chewing tobacco. By imposing the same per ounce excise on chewing tobacco as on snuff, both proposals would tax chewing tobacco a little over twice as much as they would tax snuff on a purchase-equivalent basis. Given the large sizes (relative to the pre-tax price) of the proposed taxes, this difference would significantly distort consumption choices between snuff and chewing tobacco. The after-tax price of snuff would decline noticeably relative to the after-tax price of chewing tobacco, and many who would prefer chewing tobacco at prices which reflect actual production costs would shift to snuff if either of the proposed taxes is enacted. (This point is discussed further in Section V.)

The Incidence of an Excise Tax on Smokeless Tobacco

An excise tax on smokeless tobacco which increased the price consumers would have to pay by the tremendous percentage threatened by either H.R. 3064 or H.R. 3078 would violate to a most unfortunate degree one of the most fundamental standards of tax equity. The one standard of equity which is almost universally accepted by students of public finance, and by the general public, is known as horizontal equity. The standard of horizontal equity requires that two people who have the same income pay the same tax. As with all standards, it cannot be expected that horizontal equity will ever be achieved with perfection. No matter how carefully our tax system is designed, there will always be cases where two individuals face different tax burdens even though their incomes are identical. But the inability to achieve perfection should not give license to ignore such an

obviously equitable standard as that required by horizontal equity. But this is exactly what the proposed excise taxes on snuff and chewing tobacco do. They ignore the basic fairness of treating equally those who are in fundamentally equal situations. Those individuals who choose to purchase smokeless tobacco will, everything else equal, suffer a larger tax burden than those who do not. This is the type of inequity and discrimination we should be trying to purge from, not insert into, our tax system.

Turning to another standard of tax equity, that of vertical equity, we do not find nearly the same consensus as we do in the case of horizontal equity. The fact remains, however, that the proposed excise taxation of smokeless tobacco violates almost everyone's concept of vertical equity. By a vertically equitable tax, students of public finance mean a tax which treats people with different income levels fairly with respect to each other. It should be obvious that there will be less agreement as to what constitutes vertical equity than as to what constitutes horizontal equity.

Some people feel that those who earn very large incomes should pay a larger percentage of their income in taxes than those who earn quite low incomes. In other words, it is felt that as income increases, the proportional tax burden should also increase. When the tax structure reflects this view of vertical equity, the tax is said to be progressive. Based on public opinion polls and the statements of politicians, it is clear that most people feel that taxes should be progressive. Some feel taxes should be very progressive, others feel they should be only mildly progressive, but most people favor progressivity. There

are a few who reject progressivity as an equity requirement and feel that for a tax to be vertically equitable it should be proportional, i.e., increasing the tax burden on an individual proportional to increases in his or her income. Almost no one, however, would argue that vertical equity requires that the rich pay a smaller percentage of their income in tax than the poor, which is to say that taxes should be regressive. Regressivity violates almost everyone's notion of tax justice.

Yet the proposed excise tax on snuff and chewing tobacco would be extremely regressive. The reason for this is explained by the well documented fact that consumers of smokeless tobacco products are, on average, less wealthy than the remainder of the population. Data on the distribution of male users of smokeless tobacco by household income level are shown in Table 1. (The data are presented in chart form in Figure 2.) It is apparent that the incidence of chewing tobacco and snuff use declines steadily as one goes up the income distribution. For example, just over 25 percent of smokeless tobacco users had annual household incomes in 1984 of less than $15,000, while only 4.7 percent of those males in households with incomes between $40,000 and $49,000 per year purchased these products. Indeed, fully one-half of all smokeless tobacco users had household incomes of less than $25,000 in 1984.

Further evidence that any tax on smokeless tobacco would be regressive is given by the occupational and educational characteristics of males who use chewing tobacco and snuff. (See Tables 2 and 3, and Figure 3.) Only 4.4 percent of purchasers worked in professional jobs, while 16.1 percent were either craftsmen or

TABLE 1

Percentage Male Chewing and Smokeless Tobacco Users by Household Income

Household Income Class	Percent
Less than $15,000	25.3
$15,000 - $24,999	24.6
$25,000 - $29,999	10.9
$30,000 - $34,999	14.7
$35,000 - $39,999	8.3
$40,000 - $49,999	4.7
$50,000 or more	11.5

Source: Mediamark Research Inc., Spring 1985, p. 260.

FIGURE 2. HOUSEHOLD INCOME: SMOKELESS TOBACCO USERS

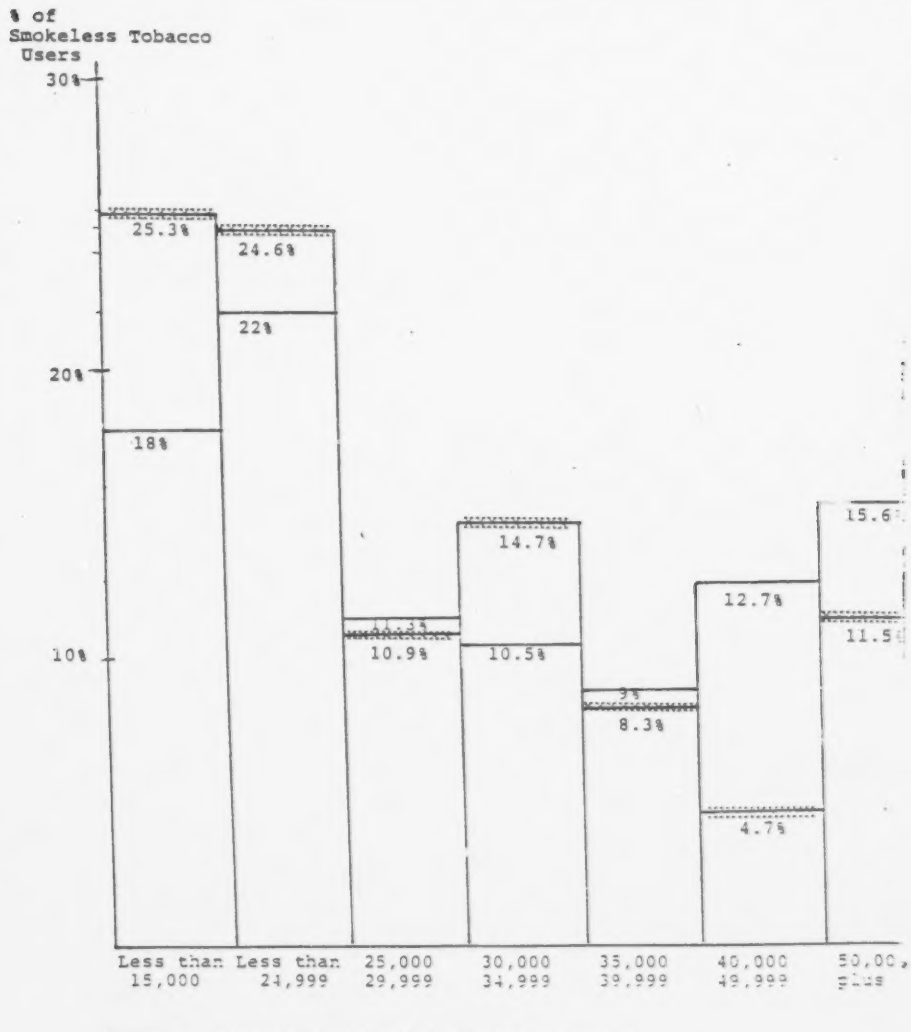


TABLE 2

Percentage Male Chewing and Smokeless Tobacco Users by Occupation

Occupational Category	Percent
Professional	4.4
Executive, Administrative, and Managerial	7.6
Clerical, Sales, and Technical	8.7
Craftsmen and Foremen	16.1
Other Employed	31.0
Not Employed*	32.2

*Includes those males who are unemployed, retired, and not in the labor force.

Source: Mediamark Research Inc., Spring 1985, p. 260.

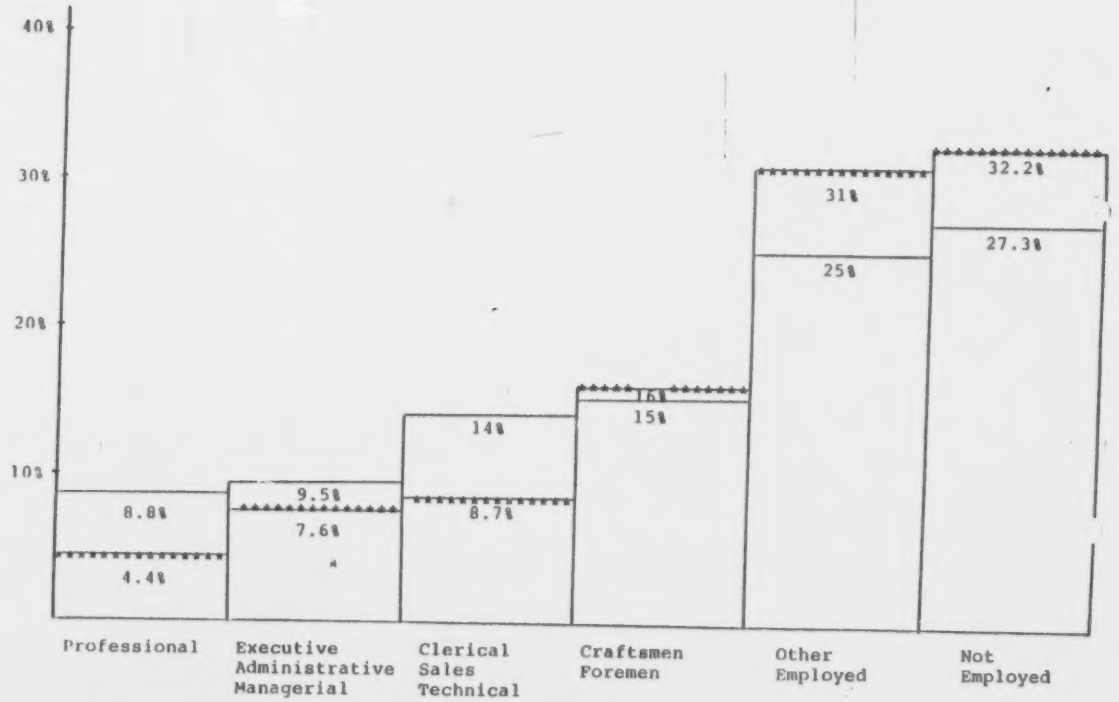
TABLE 3

Percentage Male Chewing and Smokeless Tobacco Users by Education

Educational Level	Percent
Did not graduate high school	35.1
Graduated high school	38.3
Attended college	15.1
Graduated college	11.5

Source: Mediamark Research Inc., Spring 1985, p. 260

FIGURE 3. EMPLOYMENT TYPE



foremen. Indeed, according to a survey conducted by the Home Testing Institute during the months of May-June 1984, 41.2 percent of snuff users held jobs traditionally classified as "blue collar" occupations. Such data are corroborated by the fact that nearly three-fourths of smokeless tobacco users have not received an education beyond the high school level.

In sum, there is no avoiding the unpleasant fact that the proposed excise taxes on smokeless tobacco would impose a larger burden, both absolutely and as a percentage of income, on those with low incomes than on those with high incomes. A tax on smokeless tobacco is a tax on poor people.

III. EARMARKING PROPOSALS

The case against the proposed excise taxes on either equity or efficiency grounds is clear and overwhelming. What then are the arguments put forth by those who are advocating the imposition of an excise tax on snuff and chewing tobacco? There are two basic arguments. One is based on what for many people is an irresistible urge -- the paternalistic desire to guide the behavior of others. The second, which is implied by proposals to earmark tax revenues for Medicare and Medicaid is based on the claim that those who choose to use smokeless tobacco products impose costs on others because they supposedly make excessive use of federally-financed health care programs. In this section we will consider the merits of these arguments.

The Paternalistic Argument

There are those who feel for a variety of reasons that it is not in the best interest of people to use smokeless tobacco products. Of those who profess this concern for others, many feel that an excise tax on snuff and chewing tobacco is justified as a means of discouraging the use of smokeless tobacco.

In considering this paternalistic motivation for a federal excise tax on snuff and chewing tobacco, a general comment is in

order at the outset. The tendency to believe that others would be better off if only they benefited from our tastes and preferences is widespread and strong. Fortunately, this is a rather harmless tendency if backed up by no more than our ability to persuade. History is full of atrocities of every kind, however, which point out vividly that paternalism can quickly turn ugly if it is backed up by force, political or otherwise. A major benefit we derive in the U.S. from the checks and balances contained within our constitutional democracy comes from the fact that they make it difficult for people to use government power to impose their values and preferences on others. When working as they should, these checks and balances generate what is in effect a mutual tolerance among our citizens which serve well the interests of us all. Your inability to dictate to others is more than compensated for by the inability of others to dictate to you. So we need to ask ourselves seriously whether or not we want those who feel that the use of smokeless tobacco is an undesirable practice to be able to use the power of the Bureau of Alcohol, Tobacco, and Firearms to dictate to those who feel differently. The growing uneasiness over the degree to which the tax system is already being used to exert political control over our private choices is a significant factor behind the current push for tax reform.

But quite apart from the social ethics of government-sponsored paternalism, there is the question of whether paternalists can really make much progress in achieving their objectives through the use of the tax code. Consider, for example, what the effects of increasing the price of smokeless tobacco products through an excise tax would likely be. One thing is

sure. Demand curves are downward sloping, and if the price of any product increases, everything else equal, then less of that product will be demanded. But this fact still leaves some interesting questions unanswered. For example, exactly how sensitive is the quantity demanded to changes in price, or how price elastic is demand? As far as we know, there have been no detailed studies of the price elasticity of the demand for smokeless tobacco products, so we cannot say with confidence whether the proposed excise taxes would reduce the consumption of snuff and chewing tobacco a little or a lot. To the extent that studies of the price elasticity of demand for cigarettes are any guide, the quantity of smokeless tobacco products consumed will not be very sensitive to increases in price. There is no doubt, however, that a price increase will result in some reduction in the quantity demanded.

In considering then whether or not to impose an excise on smokeless tobacco, one should ask, does it make sense to give the government more control over our private choices when the predictable consequences of doing so will be to prompt the paternalists among us to demand still further intrusions? Those who do not believe that we have already passed the acceptable limit to such practices are not likely to ever recognize such a limit.

Earmarking

Some of the legislative proposals are reported to contain provisions for earmarking part or all of the federal excise tax revenues to fund public health care programs. Such proposals are normally justified by the unsubstantiated argument that users of

smokeless tobacco place a disproportionate burden on such programs as Medicare and Medicaid. The idea is to earmark some or all of the revenues raised for Medicare and Medicaid, thus requiring those who alledgedly make the most use of these programs to pay a larger share of the financial burden.

The immediate problem with this argument is that there is a controversy about the health risks associated with many products. If we were serious about financing federal medical care programs by imposing excise taxes on any product which someone is willing to assert causes health problems, then why single out smokeless tobacco? Eggs, salt, red meat, soft drinks with sugar, soft drinks without sugar, coffee, tea, chocolate, power mowers, ladders, high decibel speakers, bicycles, motorcycles, skiing equipment, and hair curling chemicals are just a few of the large number of products which some claim cause sickness and injury, and are not now subject to federal excise taxation. It is therefore difficult to understand how anyone could think it fair to require the users of chewing tobacco and snuff to pay a special charge for the Medicare program while not imposing such a requirement on those who seek enjoyment from downhill skiing, or chocolate binges, or any one of a hundred other activities.

But quite apart from the question of whether the consumption of chewing tobacco or candy bars leads to any increased demand on the Medicare budget, it is a highly questionable proposition that people should be charged on the basis of a user fee for federal medical care programs. The laudable ideal behind publicly financed medical service is that proper medical treatment should be available to everyone in our society on the basis of their

need for care, not on the basis of the payments they make. Political supporters of Medicare and Medicaid are justified in their claim that it is the imperatives of compassion and justice which provide the rationale for these programs. But what is more at variance with this humanitarian rationale than the suggestion that low-income consumers of smokeless tobacco should face a special charge for their medical care while high-income citizens who do not consume smokeless tobacco should not?

Federally subsidized medical care is by its very nature a transfer program. It has always been understood that it would transfer income to those who made above average use of medical services from those who made below average use of medical services. The fact that it was thought desirable to make such transfers has justified the significant federal involvement in our health-care industry. If we have decided that these transfers are no longer justified and people should pay for the medical care they receive, we should be honest about it and discard the rhetoric about concern and compassion. We should also recognize that there are much better ways to improve the connection between the amount people pay and the medical care they receive than through the imposition of a clumsy excise tax on smokeless tobacco. It would be far better, for example, simply to return medical care decisions back to the market place. Not only would people be required to pay for the care they receive, but this care would be provided much more efficiently.

But, of course, we have not decided that the transfers which are the very essence of federally subsidized medical care are no longer justified. No one is seriously proposing that medical

resources should be allocated entirely through the forces of the private market. There is a good reason for this. We as a society do not want to assume the mentality of a storekeeper, making sure that no one gets something they did not pay for directly, where proper medical care is concerned. And, because of this attitude toward medical care, the suggestion that smokeless tobacco users should be subject to a special assessment for Medicare and Medicaid is completely at variance with the sense of justice upon which these programs are based in the first place.

Private Costs Versus Social Costs

The issue of governmental interference in the private activities of its citizens is extremely controversial, as is the question of how government should go about regulating individual behavior if it decides to do so. Generally, in instances where government action may be deemed necessary, the decision to interfere with private commerce and the rights of private citizens has been made with extreme caution. Such action may be taken to remedy a situation when the private market fails to produce an appropriate or desired outcome, resulting in social costs to society which can only be rectified by government intervention. For example, the costs to society of air and water pollution were deemed sufficiently high to precipitate passage of the Clean Air Act of 1970 and the Clean Water Act of 1972.

In the case of pollution, private businesses did not have sufficient incentives to reduce air pollutants or refrain from emitting effluents into our waterways. Therefore, Congress imposed sanctions against an activity it determined was harmful to

the public (i.e., pollution). Government action was taken to ensure that private businesses would take into account in their production process not only the private costs of inputs, such as capital and labor, but also the ssts of pollution were significant and that the private market, by itself, would not create the incentives for businesses to reduce pollution. This so-called "market failure" and the presence of high social costs precipitated government intervention. On the other hand, in the absence of private market failure and significant social costs, government action is not only unwarranted but can actually be detrimental to the efficient operation of our economy.

It is the contention of some that benefits would result from the smokeless tobacco legislation. There is some question, however, whether the proponents of the bills have not confused private costs with social costs in their efforts to promote adoption of the laws. Before a comparison of costs and benefits of the bills can be considered, it is important that the distinction between private costs and social costs is understood.

The Congress must first determine whether there are social costs associated with the use of smokeless tobacco, and then, if social costs are positive, it should weigh the costs and benefits of its action. The following example illustrates what we mean by "social cost".

Consider a utility which, prior to government regulation, generates electricity by burning coal. Soot, a by-product of the

production of the electricity, escapes from the utility's smokestacks. In order to generate the electricity, the utility must pay directly for capital and labor inputs. Air pollution control equipment which would remove the soot is costly and not essential to production and, therefore, the utility has no incentive to install it. As a result, the soot blows downwind and soils laundry drying on the line, cars, homes, etc., imposing clean-up costs on people living in the area. The <u>total cost</u> of the production of electricity is actually the cost of cleaning the private property besmirched by the soot (the social cost) as well as the private costs (the resources such as capital and labor). Because the utility does not account for social costs in its production process, the price that consumers pay for the electricity does not reflect the total cost of production.

In this example, the costs created by the production of the soot are <u>uncompensated costs</u> because they are not paid by the utility or its customers, but are paid by the private individuals affected by the soot. This uncompensated cost, often called an externality, represents a social cost. There are various ways to force the utility to take these social costs into account. For example, the government could actually prohibit the emission of soot from the smokestacks, thus requiring it to totally eliminate the production of soot. Alternatively, government regulations which mandate the installation of air pollution control equipment could be promulgated to minimize soot production, again eliminating the uncompensated or social costs. In both instances, government regulation of the soot production has forced the utility to internalize the social costs resulting from its behavior and, by

so doing, has increased economic efficiency. The critical point in this example is that the government action was precipitated by the presence of social costs in the production of electricity. If there had not been social costs involved, there would have been no reason for the government's intervention.

In discussing whether or not to earmark smokeless tobacco taxes, it is necessary to distinguish between the private costs of using these products and the social costs, if any. In the absence of significant social costs, government intervention is totally unwarranted.

Some proponents of such legislation always suggest that individuals who use products like smokeless tobacco suffer health consequences that cause them to be absent from work more often than non-users and that the loss of production from these workers is a significant social cost of smokeless tobacco consumption. Advocates contend that a law restricting consumption would have the salutary effect of reducing employee absences and, therefore, would provide significant benefits to the economy. In other words, it has been alleged that there are social costs associated with smokeless tobacco and, hence, social benefits to be derived from reducing its use. Closer examination of this assertion indicates that a common error, confusion of social and private costs, has been made.

As stated above, a social cost exists when one individual is made worse off by the action of another individual and no compensation is made by the offender to offset this condition. The example cited previously concerning the soot from the electric utility is an example of a social cost. Even if it were true that

individuals who use chewing tobacco and snuff are absent from work more often than nonusers and that these additional absences are caused by the products (note that there is no factual evidence supporting these two assertions), these production losses would measure the private costs to the individual user of smokeless tobacco and would not represent a social cost. The costs of absences are borne entirely by the individual in the form of lower wages, fewer promotions, and so on.

Another argument that has been made by advocates concerns the costs of increased expenditures by society for treatment of illnesses allegedly attributable to smokeless tobacco. Again, this is another case of mistaking private costs for social costs. Since the evaluation of this argument follows that of the earlier comments, it can be dispatched with less discussion.

In the case of individuals who purchase health insurance, the insurer assumes some of the possible risk that some people may have higher health costs than others, and this fact, if it is significant, will be reflected in the price of insurance premiums. These adjustments reflect the insurance carrier's judgment of the increased risk of health impairment for any activity, including the use of smokeless tobacco. This cost is internalized by the private insurer, paid by the insuree, and no social cost exists.

In this discussion, we have attempted to clarify the distinction between private and social costs of smokeless tobacco. As we have seen, given the hypothetical that use of these products results in costs, these are costs which are borne by the individual, not by society. It should also be mentioned that

attempts to est' ıte the "social" costs of ˉ ɯkeless tobacco not only confuse private and social costs, but also result in double-counting. When alleged private costs are already ɔorne by the individual, to also count these as "social" costs essentially counts these costs twice. Cost-benefit analyses of many activities often make this error and, as a result, drastically overstate costs.

IV. FISCAL FEDERALISM

There are currently 20 states which impose an excise tax on smokeless tobacco. On the basis of efficiency and fairness these excise taxes are subject to the same criticism as are those being proposed at the federal level. However, if excise taxes on smokeless tobacco are going to be imposed, there is reason for believing it is better to confine them to the state level.

The federal government has moved in recent years to reduce the aid it is giving the states. Whether this is a good idea or not is not the concern here. But if such a reduction is occurring, it follows that the federal government should also avoid encroaching on tax bases which provide sources of state tax revenue. Enacting an excise tax at the federal level, particularly of the magnitudes being proposed, would serve to crowd out the states' ability to raise revenue from the same source. The National Governors Association and the National Conference of the State Legislatures have gone on record to say that excise taxes should be reserved as a source of state revenue (letter by Donald Shea, Washington Post, August 27, 1985, p. A14).

The data shown in Table 4 suggest that excise taxes on smokeless tobacco products generate a nontrivial amount of revenue for the states that impose such levies. In 1984, for example, the states collected over $47 million from taxes on chewing tobacco, snuff, cigars, and smoking tobacco (separate

figures for smokeless tobacco were not available). Moreover, these revenues accounted for up to 10 percent of total tobacco taxes collected in some of the states (Hawaii, Idaho, and Mississippi), and never less than 1.2 percent of such revenues.

It is obvious that imposing any federal levy on top of an existing state tax will reduce the tax revenue generated at that level. This result holds even more strongly for the punitive federal excise tax rates currently under discussion. Adding a 16- or 32-cent per ounce federal excise to the tax rates now imposed by these 20 states will surely have a substantial adverse impact on the revenues listed in Table 4. This will force the states to seek other revenue sources for financing essential public services, adding to the fiscal pressures threatened by other federal tax proposals such as the elimination of the income tax deduction for state and local taxes.

The states which collect substantial tax revenues from smokeless tobacco are able to do so precisely because of the absence of a federal levy on these products. It is clear that state tax rates on the order of 40 to 50 percent of wholesale price (Hawaii, Idaho, and Washington) could not be sustained with the addition of federal taxes of the magnitudes being considered. This is just another illustration of the punitive nature of the proposed excise tax on smokeless tobacco: it would either force the states to lower their tax rates, drive the industry into bankruptcy, or both.

There is another reason for wanting to see a tax like an excise on smokeless tobacco confined to the state level. To repeat, such a tax has little to recommend it and in an ideal

Table 4

Net State Revenue from Other Tobacco Taxes*
(Fiscal Year Ending June 30, 1983)

State	Net Collections	Percentage of Total Tobacco Taxes
Alabama	$ 1,538,318	2.3
Arizona	521,037	1.2
Arkansas	3,093,659	4.9
Hawaii	1,983,631	10.0
Idaho	1,253,353	11.7
Iowa	1,158,269	1.9
Kansas	1,173,151	2.6
Minnesota	3,034,778	3.6
Mississippi	3,641,095	10.6
Montana	659,118	5.0
Nevada	833,584	4.6
North Dakota	324,486	2.3
Oklahoma	3,286,014	4.2
South Carolina	2,012,163	6.5
Tennessee	2,431,203	3.1
Texas	9,819,013	2.8
Utah	668,096	4.9
Vermont	457,912	4.4
Washington	5,229,449	5.2
Wisconsin	3,940,190	3.0
Total	$47,058,519	3.5

*Includes revenues from taxes on chewing tobacco, snuff, cigars, and smoking tobacco.

Source: Tobacco Institute, The Tax Burden on Tobacco, January 1985, p. 60.

world would not b enacted at any level. How er, if such a tax is going to be enacted, its unfortunate consequences will be more likely moderated if enacted at the state level rather than the federal level. If any particular state enacted an excise tax with rates as high as those being proposed on smokeless tobacco at the federal level, little revenue could be expected to be raised as a result. In the case of state excise taxes on smokeless tobacco, high tax rates in one state would motivate consumers to purchase their tobacco from suppliers in other states where the tax is lower. It is the possibility of this interstate tax competition which prevents taxes at the state level from becoming excessive.

V. TAX INSTRUMENTS AND TAX POLICY

Despite the overwhelming evidence that a federal tax on chewing tobacco and snuff would be highly inequitable, the Congress may nevertheless choose to impose such a levy. If it does so, it is important to consider what type of tax instrument would best achieve the policy goals set out in the proposed legislation. Both economic theory and the precedents established by the states which tax these products suggest that different tax rates should be applied to chewing tobacco and snuff.

Simply put, a uniform excise tax on smokeless tobacco would impose a significantly higher effective tax rate on users of chewing tobacco than on users of snuff. This is because the two products are typically sold in packages of different weight. Chewing tobacco, for example, is normally sold in a 3-ounce package. The equivalent for snuff is a 1.2-ounce tin. Under proposed legislation which imposes an excise of 16 cents per ounce or part thereof, chewing tobacco users would therefore be forced to pay up to 48 cents per package in federal taxes, whereas snuff users would only pay about 32 cents in taxes. The corresponding figures for a 32 cents per ounce (or part thereof) excise are 96 cents and 64 cents, respectively. These taxes range from 72.4 percent to 138.8 percent of the manufacturers' list price for chewing tobacco, and from 64.0 percent to 128.0 percent of the manufacturers' list price for

snuff in the appropriate units. An excise tax thus creates an additional inequity by imposing differential burdens on users of smokeless tobacco.

The disproportionate impact of a flat excise tax on smokeless tobacco products can be minimized by applying a lower tax rate to chewing tobacco than to snuff. There is substantial precedent for such a "classified tax" approach. (State governments which impose taxes on chewing tobacco and snuff have solved the problem in a different way. Seventeen of the 20 states that tax smokeless tobacco express the tax as a percentage of either manufacturers', wholesale, or retail price. Use of an ad valorem tax rather than an excise means that smokeless tobacco users face the same effective tax rate regardless of the weights in which the products are purchased. This strategy would be difficult to implement at the federal level, however, because the BATF does not have the resources for collecting ad valorem taxes. See Table 5.) The federal excise tax on alcohol, for example, is levied in terms of "proof gallons" in order to tax products with different alcoholic content at similar rates. Moreover, state excise taxes on cigars are often classified on the basis of type and/or weight.

To see how such a classified excise tax on smokeless tobacco would operate, consider updating the tax on manufactured tobacco abolished in 1965. As mentioned earlier, the 1965 tax was set at 10 cents per pound. To apply the same effective tax rate in 1985 to moist snuff, the tax rate should be set at 24.0 cents per pound. The purchase-equivalent tax for loose leaf chewing tobacco would be lower, however. For the total taxes on a 3-ounce pouch

to represent the same percentage of list price as for a 1.2-ounce tin of snuff, the tax rate would be set at 8 cents per pound. Classifying the tax in this way achieves tax parity between moist snuff and chewing tobacco. However, this is just an example of how tax parity could be achieved. Other classification schemes might be desirable.

In sum, a classified excise tax is to be preferred to a uniform tax because it would impose the same effective tax rate on chewing tobacco and snuff users. If the Congress chooses to impose a tax on smokeless tobacco, it is highly recommended that the tax per unit weight be set at a lower level for chewing tobacco than for snuff.

It should also be stressed that the calculations in this section are illustrative and not suggestive. First best is no tax.

TABLE 5

State Tax Rates on Chewing Tobacco and Snuff

State	Tax Rate
Alabama	Chewing Tobacco: 3/4 cents of each ounce or fraction thereof. Snuff: 5/8 ounces or less, 1/2 cent; 5/8 ounces - 1 5/8 ounce, 1 cent; 1 5/8 ounces - 1 1/2 ounces, 2 cents; 2 1/2 ounces - 3 ounces, 2 1/2 cents; 3 ounces - 5 ounces (cans, packages, gullets), 3 cents; 3 ounces - 5 ounces (glasses, tumblers, bottles), 3 1/2 cents; 5 ounces - 6 ounces, 4 cents; Over 6 ounces, 1 cent for each ounce or fraction thereof.
Arizona	Chewing Tobacco and Snuff: 2 cents per ounce or major fraction thereof. Plug Tobacco: 1/2 cent per ounce or fraction thereof.
Arkansas	16% of manufacturers' invoice price.
Hawaii	40% of wholesale price.
Idaho	35% of wholesale price.
Iowa	10% of wholesale price.
Kansas	10% of original invoice price from manufacturer to wholesaler.
Minnesota	20% of wholesale price.
Mississippi	9/16 cents for each 5 cents or fraction thereof of retail price.
Montana	12.5% of wholesale price.
Nevada	30% of wholesale price.
North Dakota	11% of wholesale price.

(Continued)

TABLE 5

State Tax Rates on Chewing Tobacco and Snuff (Continued)

State	Tax Rate
Oklahoma	Chewing Tobacco: 30% of factory list price
South Carolina	5% of manufacturers' price.
Tennessee	6% of wholesale price.
Texas	25% of factory list price exclusive of any trade discount, special discount or deal.
Utah	25% of manufacturers' price.
Vermont	20% of distributors' price.
Washington	48.15% of wholesale price.
Wisconsin	20% of wholesale price.

Source: Tobacco Institute, The Tax Burden on Tobacco, January 1985, p. 61.

VI. CONCLUSION

No matter what criteria one chooses to use for judging the worth of a federal excise tax on smokeless tobacco, one comes to the conclusion that such a tax is unwarranted. Such a tax would generate economic inefficiencies, it would grossly violate any acceptable standard of horizontal and vertical tax equity, and it would fail to achieve the dubious objective of a user fee for medical services.

The reason tax reform is now firmly on the political agenda is that over the years our federal tax system has become riddled with provisions which generate inefficiencies, discriminate unjustly against those who are unorganized politically, and fail to accomplish the objectives they were supposed to, provisions which in this regard are unfortunately like the proposed excise tax on snuff and chewing tobacco. It is ironic, and not a little disheartening, to see such proposals being made at a time when it appears that there is a real hope that tax reform will begin purging our federal tax system of such senseless provisions. A proposal such as those urging the imposition of an excise tax on smokeless tobacco could have never gotten through Congress on the basis of its merits. Let's hope that the time has come when it cannot get through Congress on the basis of political expediency. The country, the economy, and our sense of justice and fairplay deserve better.

Senator CHAFEE. Well, suppose we ignored your request and were determined to go ahead anyway. Do you have any suggestions as to what the tax might be?

Mr. KERRIGAN. Well, Mr. Chairman, it's interesting that you should raise that. I've had talks with Christine and Tom—they have made my August and September a very active one.

You talked at one time of equivalence to cigarettes. And I would like to just raise that, because I thought that was the notion.

Smokeless tobacco is to cigarettes—remember our SAT's—about as much as soda pop is to distilled spirits. Both are beverages, both are tobacco, but they are consumed differently. So we are a very different product from cigarettes. We are one twenty-second the size of the cigarette industry. And I mention our corporate tax rate is very high already.

If one looks at a historical perspective, to get to $0.16 a pack, it has taken the cigarette history, just the entire—ever since there has been Federal taxing of cigarettes. In the last 20 years, we haven't paid Federal taxes. So if you were to put the Consumer Price Index, Mr. Chairman, on one product like ours, and you were to put it on other products like liquor, alcohol and beer; I'm sure that the other industries would find their tax rates increased far more than their current tax rates. If you were to apply the Consumer Price Index, at $0.10 a pound to smokeless tobacco industry, it would be brought up to $0.24 a pound on snuff and $0.08 a pound on chewing tobacco.

Senator CHAFEE. So what are you suggesting?

Mr. KERRIGAN. Well, Mr. Chairman, as cooperative as you were last time, I don't think I should be any more cooperative because in a perfect world we would oppose all excise taxes.

Senator CHAFEE. I appreciate that, but we are not in a perfect world. So what are you suggesting?

Mr. KERRIGAN. Well, the consumer price index is certainly—that would be far more equivalent.

Senator CHAFEE. And when all is said and done, what does it come out to?

Mr. KERRIGAN. Twenty-four cents a pound for snuff, one-half of the industry; and $0.08 a pound toward chewing tobacco the other half of the industry.

Senator CHAFEE. So that comes out to a penny an ounce.

Mr. KERRIGAN. One and a half cents an ounce, I believe, Mr. Chairman. And there are reasons, because of those other products, to go into this classification system to a per poundage basis because of the diversity of our product line.

Senator CHAFEE. I think back of all this, as you know, is our concern is that we are more than just in a revenue raising business, although that there are a good deal of studies that have a causal connection between smokeless tobacco and sicknesses. The Cancer Society says 10 percent of oral cancer deaths, 10,000 a year, are linked to smokeless tobacco. That's a terrible statistic. It comes out to 10,000 deaths a year.

The head neck surgeon has found a causal connection between smokeless tobacco and oral surgery that they have to perform. You are familiar with it. The World Health Organization found a causal link between cancer and smokeless tobacco.

Now the Surgeon General, I take it, is coming out with a report in the spring.

Mr. KERRIGAN. Yes, sir. Well, he's doing what they call a consensus study. And if this consensus report is to seek new knowledge and to close the gaps of knowledge, we support it. If, as we suspect, Dr. Cohen, who has already made his views clear on smokeless tobacco—we are not too encouraged about the type of results or what shape it will take.

But I'm not here to debate with you, Mr. Chairman. I'm sensitive to your health concerns. And we want to assuage those concerns when it comes to the labeling issue, which is currently under debate, and Senator Lugar and Senator Hatch have a bill that we have been discussing with them.

We have tried to take a rather unique approach in meeting with your staff and their staff on the subjects, and that's why we were down last week with President Carter meeting with the health groups.

Senator CHAFEE. I have a question from Senator Bradley. Why shouldn't a 3-ounce pack of plug or a 1.2 ounce of snuff be taxed about the same level as a pack of cigarettes, roughly $0.16? Well, cigarettes are $0.16 a pack. Actually, if I read this question correctly, roughly $0.16 per container. In other words, if your 3-ounce plug is selling for $0.90 and a pack of cigarettes sells for a dollar and you put $0.16 on a pack of cigarettes, why not $0.16 on a plug so that you would come out at $1.06 which would be—and the $1 is with the tax.

Mr. KERRIGAN. Yes, sir.

Senator CHAFEE. As I mentioned before, the cigarette tax, 16 percent Federal. Your tax would be a little less than that. What is your answer to that?

Mr. KERRIGAN. Well, I'm glad Senator Bradley asked that question, because the answer to that points out the differences that our products are relative to cigarettes.

When I made the analogy about you don't tax soda pop the same way you tax distilled spirits, there is a reason. There are four or five different reasons here.

First, our industry size—we are approximately, if you measure retail sales, Mr. Chairman—we are one twenty-second the size of the cigarette industry. In other words, they are a $22 billion industry with a different cost structure than we have.

One could argue that by applying the Consumer Price Index, if we turn that question around to us, that we could be taxed at a rate from our 1965 rate at $0.10 a pound, if you applied that to cigarettes, they would be raised at a higher rate, which I know you are thinking of. However, I'm not here representing the tobacco institute.

And I think last, Mr. Chairman, if you look at the history of taking us, without having a tax in 20 years, up to the current levels of cigarettes, particularly before the jury is so-called out on the Surgeon General's conference and particularly in view of the fact that if you measure the weight of allegations on smokeless tobacco versus other products, the two products are not the same. In fact, at this conference, I know the heart and lung people were encouraging me. They weren't necessarily in favor of tobacco in any

shape or form, but they certainly perferred that people used our products versus other forms of products. I think they were a little tongue in cheek about it.

But the point is, Mr. Chairman, there are significant differences when you look at our product line. And particularly when he considers many different sizes and shapes and forms. Cigarette packs come in either 20 units to a pack or 25. We have, I believe, 185 different sizes and shapes of brands in the smokeless tobacco industry. Half the industry is in chewing tobacco; roughly half the industry is in snuff.

Senator CHAFEE. Well, thank you very much, Mr. Kerrigan. We appreciate you coming.

Mr. KERRIGAN. Thank you, Mr. Chairman. I appreciate the courtesy of being here.

[Whereupon, at 11:27 a.m., the hearing was concluded.]

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